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THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D. C. 20505

9 April 1974

MEMORANDUM FOR: The Honorable Henry A. Kissinger
Assistant to the President
for National Security Affairs

SUBJECT : Implications of Different FY 1975 Economic
Assistance Levels for South Vietnam

1. Attached is a memorandum which may be helpful to you in assessing the impact on South Vietnam of different U.S. economic aid levels for FY 1975. Three possible aid levels -- a low, a medium and a high one -- are examined.

2. The memorandum makes clear that a low level of aid (the one arbitrarily chosen here is a continuation in dollar terms -- but a substantial reduction in real terms -- of present aid) would result in a further deepening of South Vietnam's economic difficulties. There is full agreement in the intelligence community on this point. There are two opposed schools of thought, however, as to whether this low level would threaten the political stability of South Vietnam during FY 1975, or start an irreversible process that would threaten the GVN's stability in the years immediately thereafter. Both schools spell out their positions in some detail in the attached memorandum.

3. My own view is that the low aid level as defined herein would not lead to the collapse of the GVN. It would, however, probably result in a further economic downturn and some political unrest which would be used by the GVN's opponents abroad to question further the U.S. investment over the years in a successful Vietnam.

4. Because of the sensitivity of this subject at present, we are limiting the distribution of this memorandum very strictly.

Kissinger
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Bill
W. E. Colby

Attachment

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April 8, 1974

MEMORANDUM FOR THE DIRECTOR OF CENTRAL INTELLIGENCE*

SUBJECT: Implications of Different FY 1975 Economic Assistance Levels for the Future Viability of South Vietnam

The Key Points

This memorandum projects three possible US economic assistance levels for South Vietnam in FY 1975 and assesses the impact of each on the South Vietnamese economy.

- The Low Aid Option -- \$300 million in Commodity Import Program (CIP) aid and \$50 million in development aid -- would essentially be a continuation, in dollar terms, of the present economic assistance level. Because of global inflation, it would be a substantial reduction of real aid. Under this option:
 - South Vietnam's real imports in the first half of CY 1975 would be only about three-fourths as large as in the first half of 1974.
 - The present economic difficulties in South Vietnam would deepen.
 - Real incomes, especially among the urban population, would continue to decline, and inflation would remain a serious problem.
- The Medium Option -- \$600 million in CIP aid and \$50 million in development aid -- is the level of assistance for FY 1975 foreseen in the President's budget request to the Congress earlier this year. Under this option:

* This memorandum was drafted jointly by the Central Intelligence Agency and the Bureau of Intelligence and Research, Department of State. It was reviewed and endorsed by representatives of these agencies, the Defense Intelligence Agency, and the Department of the Treasury.



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- South Vietnam's real imports would remain essentially at the CY 1974 level through FY 1975.
- The decline in South Vietnam's economic output could be halted, but there would not be much of an upturn.
- Real incomes, among both the urban and agricultural population, could be stabilized. Urban incomes, however, would remain appreciably below those of 1970-1971.
- The High Option -- \$850 million in CIP aid and \$50 million in development aid -- is the level of assistance requested by the US Mission in Saigon for FY 1975. Under this option:
 - South Vietnam's real imports would increase appreciably throughout FY 1975.
 - The total economic output of South Vietnam could grow, in real terms, as much as 5 percent in 1975, assuming investor confidence and consumer demand were restored.
 - Real incomes of all population groups would also increase, though the 1970-1971 level could not be reached until 1976.

If the US objective is to put South Vietnam on a growth track and move it well down the road to self-sufficiency, big "shots" of assistance limited to the next two years or so will not do the job. To meet this objective, South Vietnam will need large-scale aid -- probably with major US inputs -- into the 1980s.

There are two diametrically opposed schools of thought within the intelligence community on the political implications of the aid levels discussed above:

- One school holds that even the Low Option would provide enough aid to give reasonable assurance of political stability in South Vietnam and prevent any significant

- ii -

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shift in the military balance during 1975. This school also believes that a low aid package in FY 1975 would not, by itself, create such irreversibly serious economic conditions in the South that the situation could not be rectified by larger aid packages in succeeding years.

- The other school holds that under the Low Option the GVN would run a high risk of major adverse political reactions in FY 1975. These reactions would cause instability, weaken the control of the central government, and encourage Hanoi to step up political and military pressure on the South. Even if the Thieu government survived FY 1975, a process would be set in motion which would threaten its existence in the years immediately following. In this school's opinion, there is a serious risk that this process could not be reversed before the GVN collapsed. Under the Medium Option there would be some adverse internal political reactions, but the government probably could keep the lid on the situation. The High Option, this school believes, would clearly strengthen the present government of South Vietnam.

- iii -

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DISCUSSION

Background: The South Vietnamese Economy and Recent Aid Levels

1. The large-scale mobilization in South Vietnam which began in 1965 was carried out without a significant reduction in consumption levels because heavy inflows of US economic assistance filled the gap. The US aid program from 1965 through 1970 was aimed primarily at containing the severe inflationary problems that were the by-product of huge government deficits necessary to finance military expenditures. After the 1968 communist "Tet" offensive, however, the pacification program of the Government of Vietnam (GVN) began to make real progress and economic conditions improved markedly. By the end of the 1960s, the preoccupation of the GVN -- and the US -- with stabilization lessened, and a greater effort was devoted to fostering growth in the South Vietnamese economy. With imports still financed largely by US aid and continuing at the high levels of the mid-1960s, the South Vietnamese were able to channel more resources toward increased output rather than current consumption. During 1969-1970 GNP increased at an annual rate of some 4 percent in real terms, and agricultural output increased by about 10 percent per year.

2. Beginning in late 1970, the GVN (closely advised by the US) undertook a series of reforms designed to stimulate the private sector and ultimately to end dependence on US economic assistance. The measures taken included interest rate reforms (establishing interest rates higher than the rate of inflation), domestic banking reforms to increase private saving, adoption of a flexible and realistic exchange rate policy to stimulate exports, and, by late 1971, a liberalization of import procedures to give the market system greater influence over the volume and type of goods to be imported. The response to the reform measures was favorable; by the end of 1971 the South Vietnamese economy appeared on the verge of a new departure in recovery and development. It was generally believed that, with continued foreign assistance and the establishment of greater political and military stability, Vietnam's largely untapped resource base could provide the basis of steady and relatively rapid growth.

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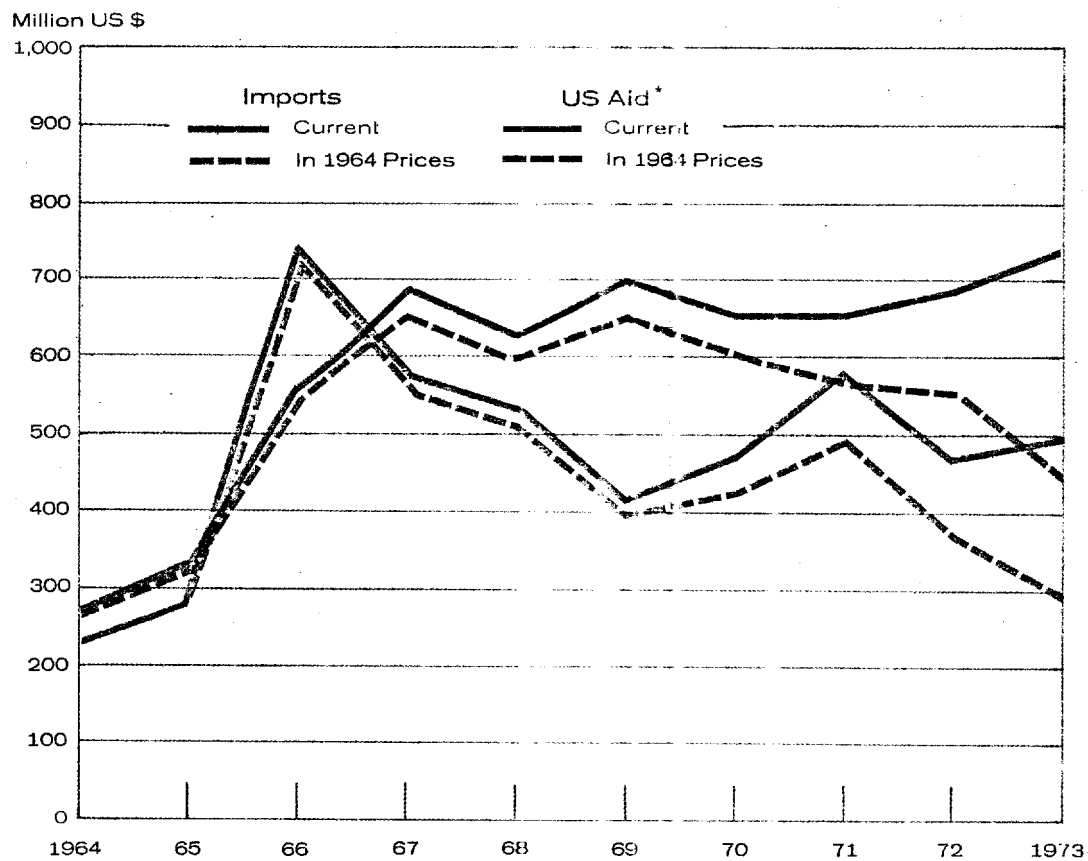
3. The 1972 Communist military offensive dashed these optimistic predictions. A recession occurred as consumer demand dropped and investment came to a virtual halt. Moreover, military disruption and poor weather combined to produce a shortfall in the 1972-1973 rice harvest. The Vietnam settlement agreement of January 1973 did little to halt the economic decline. Consumer confidence was not restored, foreign investors continued to show reluctance to make commitments, and key commodity shortages created upward pressure on prices.

4. Coupled with these problems was a steady, significant decline since 1971 in real aid levels and a commensurate reduction in real imports (see Figure 1). Indeed, in constant prices the volume of US aid fell by about one-third from 1971 to 1973, and South Vietnamese imports -- again in constant prices -- diminished by 25 percent in the same period. These declines are primarily the result of sharp increases in world commodity prices. In 1973, for example, import prices were on average some 35 percent higher than in 1972, while the actual volume of imports dropped by some 20 percent.

5. The government has made strenuous efforts to reduce imports of non-essential consumer goods and to channel reduced aid funds toward investment. Imports of consumer goods other than food account for less than 10 percent of the total import bill. Nevertheless, attempts to initiate reconstruction and steady growth have been frustrated as rising shares of the country's import bill have been diverted to meet essential commodity shortages. Food imports, for example, rose as a share of total imports, from 15 percent in 1972 to more than 25 percent in 1973. (This is reflected also in PL-480-funded imports, which rose dramatically from \$81 million in 1971 to \$144 million in 1973, and may reach \$275 million in 1974.) Imports of petroleum products and fertilizer, accounting for about 15 percent of total imports in 1972-1973, could exceed 25 percent in 1974. Suffering the sharpest declines in 1973, in both absolute terms and as a percent of total imports, and likely to be reduced further in 1974 as well, are construction materials and machinery. These items fell as a share of total imports from nearly 30 percent in 1971-1972 to about 15 percent in 1973. The lack of both demand and

Figure 1

South Vietnam: Estimated Imports and US Economic Aid



*Excludes piaster purchases.

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funds available for investment has brought a complete halt to earlier progress in reducing South Vietnam's reliance on foreign capital.

The Present Situation

6. The impact of this slump of the past two years has not been felt equally by all economic sectors. The resulting economic difficulties are concentrated in urban areas and among those with fixed incomes.* The stagnation of industrial production, rapid inflation, and the sharp reduction in US military spending have hit these groups the hardest.

7. Wages are failing to keep up with the rising cost of living, and supplies of consumer goods in local markets are decreasing. As supplies have declined, consumers -- attempting to maintain former living standards -- have bid prices beyond the range of lower-income groups. Some 1.5 million government employees, both civilian and military, received a 25 percent pay increase in 1973. Because of inflation, however, the real wages of civil servants and military personnel now are only about two-thirds what they were a year ago, continuing a decline which has been underway for several years. The wages of lower-level officials, enlisted men and junior officers now barely cover a family's expenditures for food. For most other wage earners, rice purchases alone probably take more than half of their income. This shift in consumption patterns has been reinforced by policy measures designed to cope with declining aid availabilities. For example, extremely high special duties have practically eliminated imports of such non-luxury goods as clothing and books.

8. Moonlighting and the employment of other family members help in meeting rising costs, but jobs are scarce.

* The urban population expanded rapidly in the late 1960s, a result of the intensification of hostilities and the American buildup. Urban dwellers now account for about 40 percent of the population, up from 20 percent in 1960.

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There have been some layoffs by Vietnamese manufacturers; moreover, the US Government, which in 1969 directly employed some 150,000 Vietnamese and probably indirectly provided work for an equal number, continues to reduce the size of its establishment in Vietnam. Although no firm data are available, as many as one million people, some 15 percent of the labor force, may now be unemployed in the country.

9. Agriculture remains relatively strong, recovering from a disappointing year in 1972. Real incomes among farmers, who comprise the bulk of the labor force, have probably increased somewhat over the past few years, and a good harvest is now coming in. The growth of real incomes is unlikely to continue, however, unless the supply of fertilizers and fuels is increased and the prices of these commodities are brought down. Recent increases in rice production have been due almost entirely to the greater use of high-yield varieties, more intensive application of chemical fertilizers, and increased mechanization. The retail price of fertilizer has more than doubled over the past year, and the price of gasoline has tripled. Faced with these prices, some farmers are reportedly reverting to subsistence agriculture and to the use of the traditional, lower-yielding varieties of rice. These varieties are hardier and less dependent on the vagaries of weather, require less fertilizer, and are easier to cultivate without gasoline-burning machinery.

10. If such a shift became widespread, farmers would probably still be able to meet their own needs as well as insulate themselves somewhat from external market forces. But private merchants or government representatives would find it increasingly difficult to purchase delta rice for shipment to Saigon and other rice-deficit areas of the country. Further increases in paddy prices would eventually bring forth the needed production response from farmers, but these prices had already nearly doubled in 1973. More price increases would either further burden low-income urban families or, if the government attempted to subsidize rice sales, put added strains on a government budget already showing a large deficit.

11. In the area of foreign trade, South Vietnam's outlook is also cloudy. Despite a rapid growth of exports from a very small base, total earnings from this source are unlikely to reach \$100 million in calendar year 1974. Assistance from

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countries other than the US (primarily Japan and France) will probably show some increase, but in 1974 the total amount will still make only a small dent in Vietnam's import requirements. South Vietnam's imports in 1973 totaled some \$765 million. Unless imports are to decline catastrophically, the bulk of them must continue to be financed by US aid. Moreover, since prices for major import items (fertilizer, rice, wheat, petroleum products) are markedly higher now than they were a year ago, the same volume of goods imported last year would cost about \$1 billion in 1974.

Aid Alternatives and Economic Prospects Through Mid-1975

12. In the material that follows we have projected three possible Commodity Import Program (CIP) and development aid scenarios for FY 1975 and have attempted to assess the economic and political prospects in South Vietnam under each. The three scenarios are:

- a low case, reflecting continuing appropriations on approximately the same level as FY 1974: some \$300 million in CIP aid and \$50 million in development aid.*
- a medium case, reflecting the President's request to Congress for FY 1975: some \$600 million in CIP aid and \$50 million in development aid.
- a high case, reflecting the request of the US Mission in Saigon for FY 1975: some \$850 million in CIP aid and \$50 million in development aid.

13. It should be borne in mind that external aid is only one factor influencing the economic situation of South Vietnam. A lack of business and consumer confidence has kept private

* The FY 1974 aid appropriation includes a basic \$300 million for CIP funding plus a \$50 million development loan. A supplemental appropriation of about \$50 million has also been requested for FY 1974. Although prospects for an FY 1975 development loan do not look good at present, it is assumed for all three cases, \$25 million to be used in each half of the fiscal year.

sector demand below what it would be in a peaceful, stable Vietnam. Since the communist offensive of 1972 and the succession of austerity measures necessary to cope with global and domestic inflation, the private sector (particularly in industry and commerce) has been reluctant to invest or plan business expansion. This problem will not be solved by increased aid levels alone, although higher aid -- and the US commitment it would signify -- would clearly affect the climate in which Vietnamese and foreign businessmen made their decisions.

14. Projections of the volume of aid and imports are dependent not only on absolute levels but on the choice of import price deflators as well. The average price of imports into South Vietnam is estimated to have increased 35 percent in 1973, despite the fact that the sharpest price increases did not occur until the fourth quarter. Although some slowdown in global commodity price inflation is likely this year, increases already registered -- plus continued pressures in particular commodity lines -- will probably raise average 1974 import prices another 35 percent (projections range from 25 percent to 50 percent). For this study, no attempt has been made to project a possible break in world inflation; increases are, instead, split roughly equally between the first and second halves of this year. A further rise in import prices of 10 percent (in dollars) is assumed for the first half of 1975.

15. It should also be borne in mind that the impact of FY 1975 aid levels will be affected by events in the last three months of FY 1974 (April-June). If the present high rate of CIP licensing continues unabated, FY 1974 funds may be depleted early in May. If an emergency supplemental appropriation cannot be obtained, no further CIP funds could be used until next fiscal year's appropriation became available, probably sometime in July. The instability and uncertainty generated by even a short CIP closure could in turn have a measurable effect in depressing South Vietnamese economic conditions in the early months of FY 1975. Speculation would almost certainly mount, as many importers assumed that licensing through US aid funds would not again be available at

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levels comparable to the past. Although imported goods would continue to flow into South Vietnam for a while under previous orders, business confidence would clearly be adversely affected.

16. The GVN's flexibility in dealing with a shortfall of US import financing in May and June of this year is limited by its relatively weak foreign reserve position and by a virtual halt in recent US piaster purchases. Declining US piaster needs, combined with a rapid buildup in piaster holdings generated from last year's PL-480 program, may allow the US to meet its total local currency requirements for the rest of CY 1974 without further purchases. Although GVN dollar earnings from US piaster purchases have declined in recent years, they still amounted to some \$130 million in CY 1973.

17. The impact of an immediate funding crisis arising from the above factors is discussed under the Low Option case below; although it could occur under any of the three scenarios, its impact would be sustained through FY 1975 only under the Low Aid option.

18. The three aid options and the projected import levels they would support are summarized graphically in Figure 2.* In addition, per capita import trends for South Vietnam and several other Asian states are shown in Figure 3.

Low Aid Option

19. Under this scenario, world price increases would mean a modest reduction in South Vietnam's real imports in CY 1974, and a further reduction in the first half of CY 1975 (see Table I). The Commodity Import Program (plus development loans) would provide about \$350 million to South Vietnam for FY 1975. PL-480-funded imports would increase considerably because of higher world rice prices and reliance on the program for stabilization purposes. Piaster purchases by the US, however, would drop significantly -- as they would under all three options -- through CY 1974 and the first half of CY 1975.

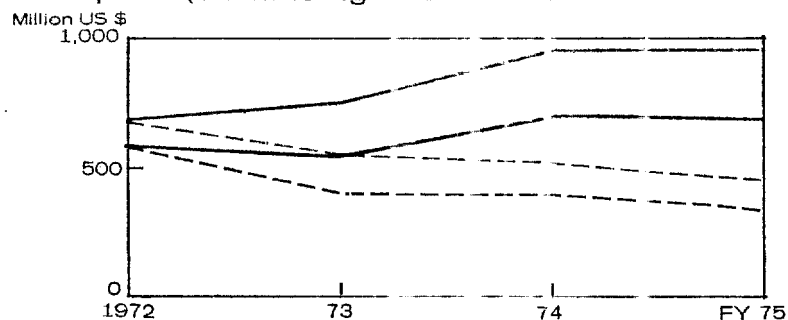
* See Annex for a statement of the assumptions which underlie all of the projections in this memorandum.

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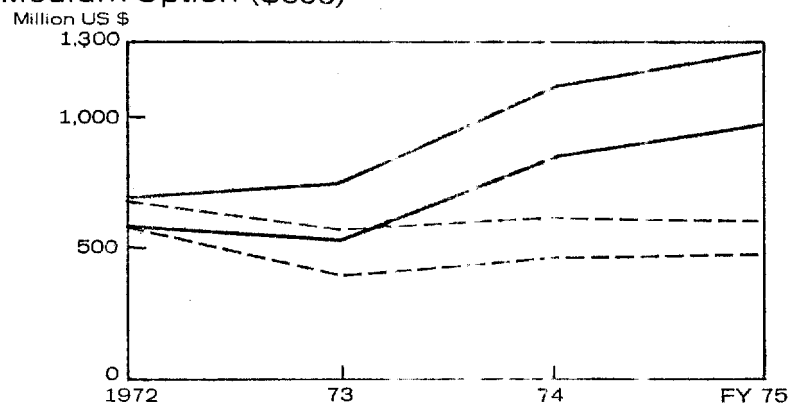
Figure 2

South Vietnam: Imports and US Aid* Under Three Funding Alternatives for FY 1975

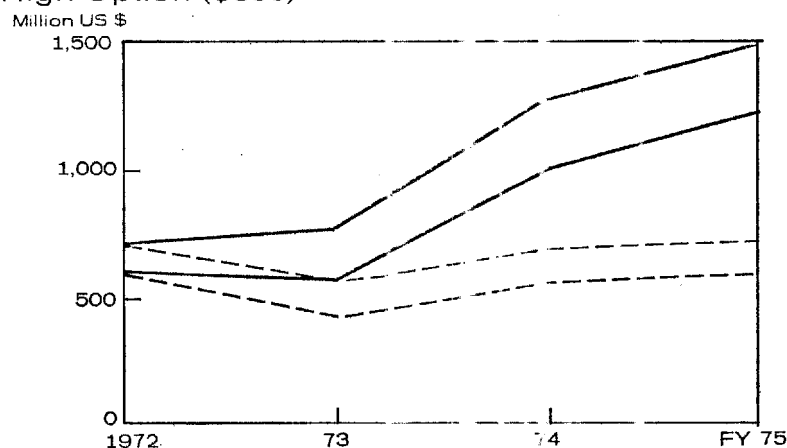
Low Option (Continuing Resolution)



Medium Option (\$600)



High Option (\$850)

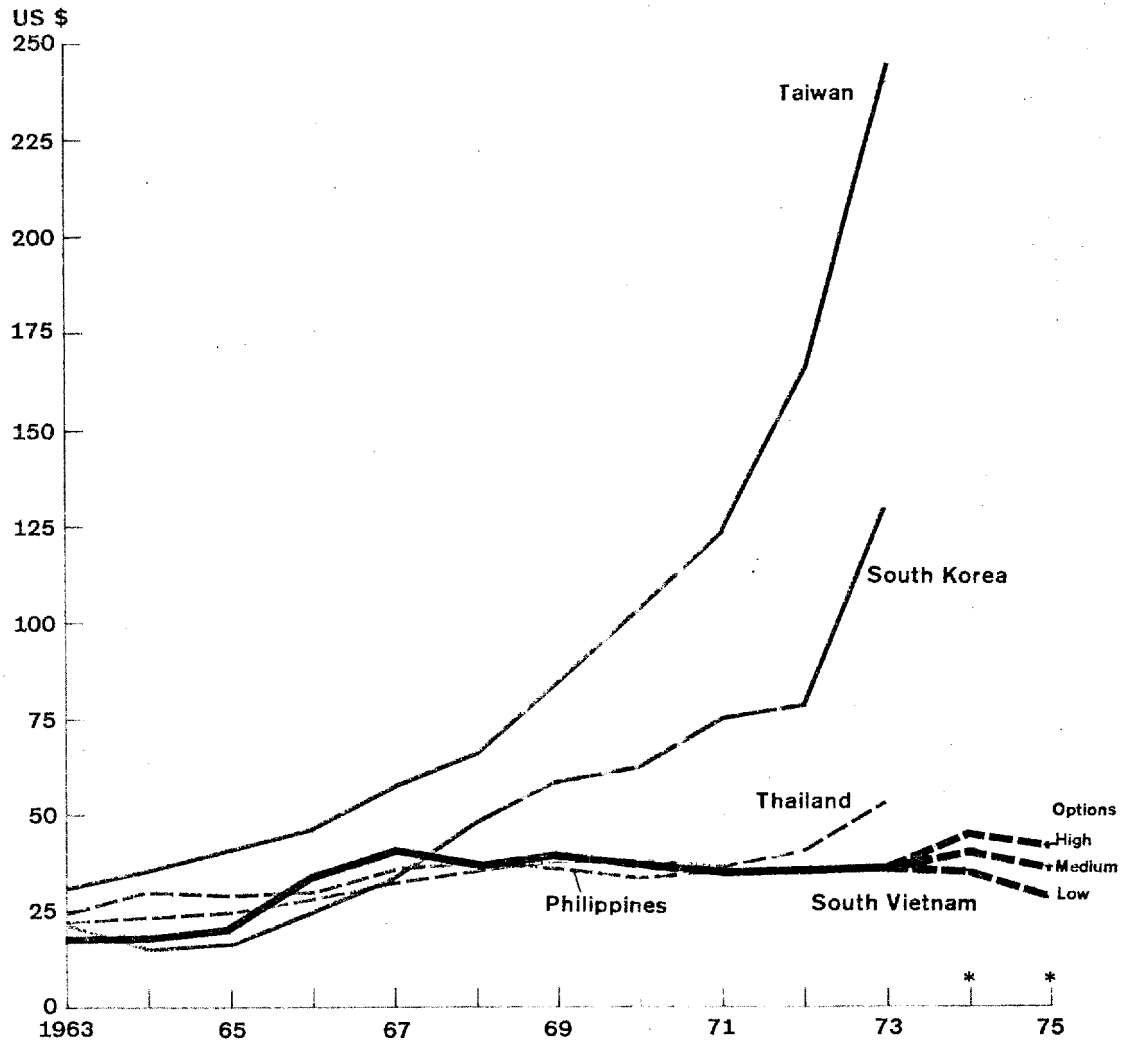


*Including US piasters purchases

Nominal 1972 Prices
Imports ———
US Aid - - - -

Figure 3

**Per Capita Imports:
Selected Countries and Projections for South Vietnam**



*For purposes of comparison with other countries, the 1974 and 1975 values for South Vietnam are computed in 1973 US dollars based on annual price increases of 35% and 20% respectively. The 1975 import level is derived from annual rates of the projections for the first half of 1975.

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South Vietnamese exports would probably decrease gradually from a high point in the first half of CY 1974 toward a stable level near \$4-5 million per month in the first half of CY 1975, as production suffers from rising costs and the unavailability of capital for replacement and expansion. Invisible earnings (other than plaster purchases) would also be likely to decline through FY 1975 as the poor state of the economy fails to attract foreign businessmen and tourists. Although limited in its capacity to do so, the GVN would probably be forced to draw its foreign exchange reserves down to the equivalent of one month of imports at the end of FY 1975.

20. South Vietnam's projected imports for FY 1975 under the Low Option would be less than two-thirds the annual volume of imports in 1970-1971. Consequently, as FY 1975 progresses South Vietnam would be forced to shift increasingly to imports for current consumption -- largely food and fuels -- and forego many of the foreign inputs required for economic development. The few capital goods imported would probably be for support of the agricultural sector, since the continuing business slump would preclude many industrial imports.

21. Although South Vietnam's economy would be seriously affected by such a decline in resource flows, day-to-day economic activities would naturally adjust somewhat to the new order. Farming would revert to more traditional patterns using greater amounts of labor. Smaller industrial firms with unsophisticated equipment and needs might find some domestic substitutes for their inputs. Larger industries, dependent on key fiber, food, and machinery imports, would be hard hit.

22. The real import levels resulting from the Low Option would not provide the South Vietnamese economy a basis for any growth at all. Investment would remain depressed and a further real decrease in GNP would be likely, particularly if fuel, fertilizer and transportation problems in the agricultural sector continue. Inflation would remain a serious problem, and there would be continued declines in real income.

23. Even under the Low Option, the South Vietnamese Government would probably carry out a modest nominal increase in

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salaries for government workers and military personnel, but not one which would keep step with inflation. Moreover, the reduction of aid arrivals would be sharper in the first half of CY 1975 than in the last half of CY 1974, and this would deepen real income declines. The result would be a further perceptible deterioration in living standards, particularly in urban areas. The real incomes of most urban families would probably fall to a level that would cover little more than a modest diet, limited clothing expenditures, and shelter. Unemployment would also probably increase above present levels, as imported industrial inputs became scarcer and more expensive.

24. The cost of imported goods under the Low Option would almost inevitably continue upward, not only because of increasing global prices but also because of government efforts to limit imports. The GVN would almost certainly impose more and higher import taxes, for example, under the low funding scenario, and these taxes would affect the prices and availability of industrial inputs, key commodities, and those few non-food consumer imports now allowed.

25. If the Low Option for FY 1975 were accompanied by a serious funding shortfall in the remaining months of FY 1974, the above problems would be magnified. Moreover, even a short-term import crisis could have a serious impact on general living standards. The natural concentration on commodity imports under limited funding availabilities would be further spurred by import speculation and a run on licensing. Importers would attempt to take advantage of the uncertainties by increasing both inventories and prices of imported goods. Windfall profits, common in the late 1960s but largely eliminated by the exchange and import tariff reforms of 1970-1972, would probably become a problem again, resulting in a renewal of income transfers to a small group of Saigon speculators.

26. A basic problem facing the South Vietnamese Government under the Low Option is that the government has few new administrative and financial tools to cope with its economic problems, particularly in the short run. This was demonstrated in 1973 when a series of emergency measures had little impact except for forcibly drawing rice reserve stocks out of the delta. Import controls -- including increased taxes, outright bans, and

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rationing of specific commodities -- as well as more direct government intervention in rice marketing and subsidies of various kinds for various groups, were all tried with little success. By early 1975, the GVN would be faced with heavy pressures for further government controls -- more stringent than those applied in CY 1973 and early CY 1974, but probably no more effective.

Medium Aid Option

27. The Medium Option would provide CIP and development loan aid of \$650 million to South Vietnam in FY 1975. Under this option, capital inflows and GVN exchange earnings through FY 1975 should show a marked improvement in comparison with the Low Option (see Table II). In particular, a CIP of \$600 million (plus development loan financing of \$50 million) should allow imports in the first half of FY 1975 to increase significantly more than they would under the Low Aid option, and prevent them from declining in the second half of FY 1975. Adequate imports of raw material and capital goods, in turn, and a reasonably healthy business climate would support expanded export growth. Similarly, invisible receipts could be expected to improve. The competition for imports between the agricultural and industrial sectors might be greater under the Medium than under the Low Option, and this might hold the growth of agricultural output below potential if imports of fertilizers and pesticides, for example, diminished. The PL-480 program would probably have to be maintained at a high level because of continued high world rice prices, slow growth in the South Vietnamese agricultural sector, and stabilization requirements. Under this option, South Vietnam would also have to draw on its foreign exchange reserves during the first half of FY 1975, but by the end of the fiscal year, total capital inflows would be such that some improvement in reserves should occur.

28. The level of imports allowed under the Medium Option would still be such that food, fuel, and other basic consumer items, would account for most of the total. There would be little funding available for many types of consumer imports normally found in countries at this stage of development. More important, little increase would be possible -- in real terms -- in raw material and capital imports. Investment would continue at a low rate and little reconstruction would take place. Some

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real growth in the private sector probably would occur, but it would come less from new investment than from increased use of existing capacity as the economy recovered from the stagnation of 1972-1973.

29. The positive impact on living standards under this option would be limited in CY 1974, but the declines registered in 1972-1973 should nevertheless be halted by the end of the year. Moreover, assuming that this level of funding were accompanied by a commensurate recovery in domestic economic activity, real incomes would probably register some gains by mid-1975. In particular, salary increases for government workers and military personnel could just about match domestic rates of inflation since early 1973, even though real incomes for these groups would still remain below those of 1970-1971. Under the Medium Option, employment in the private sector should also increase modestly, but industrial recovery would be slowed by the higher cost and scarcity of petroleum inputs, the effects of which are likely to remain serious through FY 1975. Moreover, farm incomes, which increased in 1971-1973, would probably level off under this option because of the sharp jumps in fuel and fertilizer costs in late 1973. The government would probably attempt to introduce regulatory measures to reduce the cost of these imported agricultural inputs. This would lessen the impact of rising import prices, but agricultural growth would nevertheless be slow.

30. In sum, under this level of funding, the GVN would be able to allow somewhat more private sector initiative in economic activity than in 1973. Through FY 1975, however, there would be little scope for policy innovation or increased government investment. Inflation would continue to be a serious problem with few options open to the government for stemming it. The decline of real incomes could be halted and perhaps reversed, but not to the extent of redressing the decline in living standards of the past several years.

High Aid Option

31. The High Option would provide CIP and development loan aid of \$900 million to South Vietnam in FY 1975 (see Table III). Likely to offset this increase somewhat would be a decline in PL-480 aid because of increased agricultural production

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within South Vietnam. On the other hand, exports would grow rapidly under the High Option because needed raw material and capital inputs would be available. Invisible receipts would also benefit from the improved business climate and the future growth potential of the economy. All these factors would combine to slow the rate of foreign exchange depletion during the first half of FY 1975 and result in a substantial expansion of reserves in the last half of the fiscal year.

32. In real terms, the volume of imports under the High Option would still be slightly below the 1970-1971 average, but it would be sufficient to support moderate economic growth. Financing would be available for an adequate level of industrial and agricultural imports, in addition to basic consumer imports. The level of "luxury" imports would almost certainly not increase because of continuing government restrictions.

33. The full amount of the High Option aid (and the imports of almost \$1.5 billion) probably could not be absorbed by the GVN economy during FY 1975 but it would be possible to rebuild the depleted aid pipeline and foreign exchange reserves. Nevertheless, rapid short-term recovery and growth could take place if private sector confidence and import demand were restored by US government approval of the High Option. The key problem is that of encouraging the private sector to buy the goods. Foreign assistance can pay for the dollar cost of imported commodities, but ultimate sale must be financed by piaster expenditures. For an agricultural economy like that of Vietnam, the problem is made more difficult because this sector does not respond quickly to monetary stimulation. Thus, if investor and consumer demand were restored, real growth in excess of 5 percent would be possible with the High Option aid funding. Although there might be a temptation to encourage a much more aggressive role on the part of government in productive investment, this sort of development strategy, in addition to working against the US preference for greater private initiatives, would require many more well-conceived and carefully-planned projects than could be generated in this period. Even with major reconstruction expenditures, the full amount of a \$900 CIP and development aid program probably would not be spent by the end of FY 1975.

34. Assuming that most of the \$900 million were spent, however, there would be substantial improvement in private sector employment and wage conditions, particularly in the second half

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of FY 1975. Moreover, government receipts under this option should allow not only real wage increases for government employees and military personnel but possibly also some expansion of government employment in reconstruction/development activities. If a significant portion of this aid were channeled into projects, a further increase in private sector employment could also result. Even this level of aid, however, would not entirely insulate the average Vietnamese from the effects of global inflation. Under the best of circumstances, with continued large-scale foreign capital inflows accompanied by domestic economic recovery, the average living standards of 1970-1971 probably would not be reached again until 1976 or beyond.

35. The High Option would also allow the government to retreat from its recent efforts to control economic activity directly. A relaxation of import controls would, for example, allow a more rational and responsive distribution of available financing. To a greater degree than in the Medium Option, this option would also permit a focus on retaining and expanding the 1971-1972 interest and exchange rate reforms which allow the price adjustments necessary to keep the Vietnamese private sector growing in tune with changing global economic conditions. Even the High Option, however, probably would not solve Vietnam's problem of domestic inflation during the period under review, as increasing import costs rather than excess demand will remain the major factor. Nevertheless, this option does provide the basis for more optimistic predictions for real growth and stabilization beyond FY 1975, assuming that continued foreign capital inflows are forthcoming. Moreover, the increase of real resources available to the economy would allow the government to attempt income redistribution measures with less likelihood of absolute income declines among particular population or economic groups.

Implications for Future Growth and Aid Requirements

36. Overall aid requirements for moderate growth -- or the US share of them -- will not decline significantly during the next five years. That is, given the low base from which South Vietnam begins, the attainment of steady economic growth will not result from big "shots" of capital limited to the next two

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years or so. An initial surge can at best be expected to *start* a movement toward self-sufficiency, not to attain it. No country at a stage of development similar to that of South Vietnam today has ever come close both to sustaining growth and to covering its trade deficit through exports and "normal" capital inflows in less than 15 years.

37. Unless South Vietnam continues to receive -- for the rest of this decade at least -- annual foreign capital inflows similar to those at present (in constant prices), it will not have moved significantly beyond the living standards and real income levels that obtained when the US began its massive military and economic aid in the mid-1960s. So much has taken place in the global and domestic economies since mobilization shifted large numbers of the best workers into the armed forces, that prospects for accelerating the pace of recovery or shortening the period of "client" status for South Vietnam are not good. If the US objective still is to put South Vietnam on a growth track and move it well down the road to self-sufficiency, it is likely that South Vietnam will continue to be dependent on US aid into the 1980s. The only development which conceivably could speed the movement toward self-sufficiency would be major oil discoveries in areas under South Vietnamese control.

The Political Factor

38. In Vietnam as in the rest of the world, it is impossible to define precisely the relationship between economics and politics. Nor is it possible to identify that point at which a nation with growing economic problems starts to experience serious political instability. In the case of South Vietnam, there are two schools of thought within the intelligence community on the political implications of the economic aid levels discussed in this memorandum. The arguments of these two schools are presented below.

SCHOOL A: This school holds that even the Low Option would provide enough aid to give reasonable assurance of political stability in South Vietnam and prevent any significant shift in the military balance during 1975. This school also believes that a low aid package

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in FY 1975 by itself would not create such irreversibly serious economic conditions in the South that the situation could not be rectified by larger aid packages in succeeding years.

39. Analysts who support the School A case argue as follows:

a. It is unlikely that the economic conditions projected under the low case option would directly threaten the stability of the GVN through FY 1975. This is not to deny that there would be some political cost -- for instance, declining morale in the armed forces and perhaps some popular alienation from the Thieu government. The levels of assistance under the medium and high options would reduce such effects and would improve the relative position of the GVN vis-a-vis the Vietnamese Communists. The long-term survivability and effectiveness of the GVN, however, will depend on a wide range of factors; economic problems in the short range at least, are not likely to give the Communists any critical or clearcut advantage in the continuing struggle between the North and South.

b. Having withstood intense military, political and economic pressures in the past, South Vietnam is in many ways relatively well equipped to face even greater economic problems without political breakdown. There is no sign that Thieu's tight control and political strength is weakening and no particular reason to question his ability to handle any political repercussions with his usual skillful blend of political finesse and, where necessary, tough security measures.

c. A further worsening of the economic situation in FY 1975 is anticipated by the populace and its psychological impact may have already been somewhat dissipated. During the present economic slump, the government has steadily increased its involvement in regulating the economy, thus bringing to the attention of the public the magnitude of the problems and the government's concern with meeting them. The administration

- 18 -

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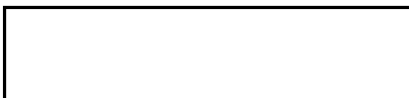
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has regularly informed the public that the economic road ahead will become rougher. President Thieu also has stated repeatedly that South Vietnam must take the load on its own shoulders in solving its domestic economic problems with lesser amounts of US assistance.

d. The bleak forecasts and repeated calls for belt tightening have not triggered significant public expressions of dissatisfaction with the government. While all sectors of society have expressed degrees of concern about the economic situation, the prevailing attitude has been one of grudging acceptance, if only for want of a feasible alternative. The South Vietnamese population generally recognizes that conditions and prospects in Communist-controlled areas are even more bleak and unacceptable. There is also a general realization that no other government policies or group of South Vietnamese leaders would be any more successful in securing greater US or other foreign aid than have Thieu and his administrators.

e. Any economically-derived political tensions would likely originate from one or a combination of three major groups: the military, Buddhists, and labor. The military is the most capable of challenging Thieu's authority. It is highly unlikely, however, that it would do so if only for fear of losing all forms of US assistance and support. Military officers would be quite hesitant to move against Thieu unless they were certain that the US wanted a change and would support it. In any event, there are now no signs of disaffection within the upper levels of the military over economic problems.

f. A more realistic concern is the likely effect of worsening economic conditions on the rank and file of the Vietnamese Armed Forces (RVNAF). As belts are further tightened within RVNAF -- already hard hit by inflation -- the familiar problems of corruption and moonlighting are bound to intensify, as they will in other government services. There have been scattered



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reports of troops stealing from the populace and engaging in other forms of corruption recently, but this does not appear widespread or even much, if any, above normal levels. It was a very widespread problem in the mid-1960s, yet did not produce any breakdown in political order.

g. Tougher economic conditions almost certainly will take some toll in troop morale and may contribute to a perceptible decline in combat effectiveness, but they are unlikely to result in a significantly adverse shift in the existing military balance in the South at least through 1975. Historically, economic problems have had little effect on the military's combat effectiveness. Despite the reduced levels of real income, ARVN is reputed by most observers to have become more professional, more confident, and a better fighting machine during the past few years. It has taken the combat to the Communists in an aggressive way. The state of the economy seems unrelated.

h. As long as the country continues to be controlled by President Thieu and the military, it is quite possible that the position of the ARVN rank and file could become more attractive in a worsening economic situation when viewed against the privations of other less privileged groups or against those under Communist control. The government is in a position to control the availability and price of rice for ARVN and its dependents more effectively than for the urban population. Although ARVN has already been hit hard by inflation, the government could ultimately be expected to take strong action to keep ARVN morale from disintegrating -- if that were a prospect -- even at the expense of other South Vietnamese on fixed incomes.

i. The Buddhists have traditionally focused on political rather than economic issues. They have some potential for fomenting local unrest, but factionalism and other problems probably would prevent

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them from rallying any widespread antigovernment support. The Buddhists, in fact, might serve as a stabilizing rather than a disruptive force. They are strongly anti-Communist and thus might view any political exploitation of economic hardships as ultimately serving Communist ends.

j. Although hard hit by inflation, organized labor -- a relatively small proportion of the total labor force -- has tended to support the central government. Such support is likely to continue and may even be reinforced by the same considerations that militate against political agitation by the military and by the Buddhists -- the need to maintain US support and the lack of an acceptable alternative. While labor leaders can be expected to encourage mass action to protest localized shortages and other economic grievances, they have the capability to keep such activities under control. The government is not likely to face a nationwide challenge from organized labor.

k. There is always some possibility of widespread unrest sparked by other groups, e.g., students, veterans, or unorganized labor. It was such unrest which surprised and toppled the military administration in Thailand in 1973. In such a situation the government involved have usually been out of touch with their populace, and had taken little or no prior action to deal with the developing problem. This is not characteristic of the Thieu administration, which has actively attempted to cope with its situation and which is in close touch with its populace.

l. From the North Vietnamese perspective, there can only be encouragement at the South Vietnamese economic difficulties. Hanoi is clearly alert to Saigon's economic problems. COSVN has warned its cadre to be ready for "sudden developments" arising out of the economic situation that may present an opportunity to "destroy the enemy." But the economic situation is only one factor that Hanoi must consider in determining its strategy toward the southern struggle.

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m. Through the end of FY 1975 the South Vietnamese economic situation seems unlikely by itself to present Hanoi with many exploitable opportunities. The Communists currently lack the assets to exacerbate significantly any economic troubles or to turn them to their direct political advantage. They would not have much chance of successfully exploiting such difficulties until the problems had sapped the strength of the Saigon regime and made the South Vietnamese populace more receptive to Communist pressures and blandishments. At this point (other considerations being favorable) they might move, through some combination of military and political action, to take advantage of Saigon's economic troubles. But economic deterioration of the sort that might provide such openings is not likely to occur in the next year or so.

n. There can be no doubt that the deleterious impact on South Vietnam which would be produced by the low option aid package would be greatly magnified after FY 1975 if a similar low level of real US aid were continued in succeeding years and if there had been no substantial inputs into the GVN economy from other sources (such sources might include oil revenues or increased foreign investment). We do not believe that a low aid package in FY 1975 by itself would create such irreversibly serious economic conditions in the South that the situation could not be rectified by larger packages in succeeding years.

SCHOOL B: This school holds that under the Low Option the GVN would run a high risk of serious adverse political reactions in FY 1975. These reactions would cause instability, weaken the control of the central government, and encourage Hanoi to step up political and military pressure on the South. Even if the Thieu government survives FY 1975 under the Low Option, a process would be set in motion which would threaten the existence of the government in the years immediately following. In this school's

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opinion, there is a serious risk that this process could not be reversed before the GVN collapsed.

40. Analysts who support the School B case argue as follows:

a. The present government in South Vietnam has enjoyed a high degree of political stability since the late 1960s. It has also established a relatively effective administration from Saigon down to the village and hamlet and has been successful at eroding Communist political control in the countryside. Part -- and perhaps a large part -- of the GVN's political achievements, however, must be attributed to the economic stability of the period and the economic opportunities enjoyed by a rather large segment of the population. This in turn was made possible by regular large doses of US assistance over the years. South Vietnamese society has undergone a significant transformation in the last decade. The dramatic shift in population from rural to urban areas has created a situation in which it is very difficult to judge the impact of economic privation. Belt tightening, the traditional Vietnamese reaction to hardship, may have new limits under these circumstances.

b. In the past two years, South Vietnam has experienced a severe decline in living standards. Those hardest hit have been urban residents and those living on fixed salaries, mainly the military and civil service. Thus far there has been little overt political reaction, and President Thieu's control of the political scene remains intact. However, virtually all Vietnamese government officials, starting with Thieu, appear to be greatly concerned about the economic situation and the potential political dangers. The Communists also appear to be counting strongly on the possibility that economic problems will weaken the GVN.

c. Short Term Implications of the Low Option: Under the Low Aid Option, it is likely that in FY 1975 the GVN would start to face serious political reactions. The

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reactions might take several forms, each of which would have the effect of weakening central government control and creating political instability:

- With continuing inflation and rising unemployment, unrest in the hard-hit urban areas, especially in the cities in Central Vietnam, is likely to increase. There is a significant possibility of strikes by organized labor and of demonstrations led by veteran groups and religious and political organizations in Central Vietnam and Saigon.
- The morale and combat efficiency of ARVN will decline. All military commanders admit that this problem is significant, although it has yet to have a debilitating impact. It is impossible to predict if there is a critical point at which a breakdown in combat effectiveness will occur, and it is likely that ARVN will continue to fight even if its back is to the wall. RVNAF's capability to protect rural areas and to conduct offensive and counter-offensive operations, however, could be seriously reduced.
- The Territorial Forces and the National Police will be placed under even more serious pressure. Since they lack the pay and privileges of full-fledged ARVN members and are more susceptible to influence from the population around them, deterioration of their economic position will increase tendencies toward neglect of duty and in some cases accommodation with the enemy. Since these forces constitute the first line of defense against Communist guerrilla warfare in many parts of South Vietnam, dissatisfaction among them does not need to reach the point of active expression of dissatisfaction with the government to have a seriously debilitating effect on security.
- Corruption is likely to become a serious political problem for the GVN. Saigon will almost certainly institute more government controls which

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will result in a growing black market and widespread illegal payoffs. The GVN will not be able to increase civilian and military salaries adequately to keep pace with inflation; the resulting decline in real wages will result in more corruption. There have recently been an increasing number of reports of troops selling their equipment and in some instances even selling ammunition to the other side. There are also increasing incidents, especially in MR 1, of armed robbery by ARVN troops. Continued corruption could begin to impact seriously upon the morale and combat efficiency of ARVN.

- Declining military and civil service morale and growing corruption will adversely affect the implementation of GVN programs at all levels.
- As economic and attendant problems mount, continuing shake-ups in high-level leadership are likely in order to seek new solutions or affix blame. Uncertain and erratic policy direction will result.
- The Communists could make some psychologically important political gains by taking advantage of GVN vulnerabilities. Rebuilding of the rural infrastructure and recruitment of Communist sympathisers in the cities will be easier, and increasing numbers of South Vietnamese may opt for a neutral stance.
- Communist propaganda to depict the GVN as thoroughly rotten and lacking popular support will gain wider acceptance, both within South Vietnam and internationally. The GVN will probably lose ground internationally to the PRG.
- In short, under the Low Aid Option the GVN would run a serious risk of major adverse political reactions in FY 1975.

- 25 -

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d. Hanoi's Reaction: The North Vietnamese are counting on the GVN's having major economic problems this year. They are certain to exploit the situation in some form. Communist cadre will step up subversive activities if there is rural economic dislocation and urban disorder. Indications that the GVN was seriously weakened by economic and political problems would encourage Hanoi to step up its political and military pressure on the South.

e. Long-Term Implications: Under the Low Aid Option, even if the Thieu government survives the political consequences of the adverse economic situation in FY 1975, a process would be set in motion which would threaten the existence of the government in the years immediately following. Some of the processes and tendencies described in paragraph c above are already beginning. Others will begin to develop in the coming year. With the Low Aid Option for FY 1975, it would be very difficult to reverse them even if a considerably higher aid level were provided for FY 1976. Moreover, the further deterioration in the GVN's situation during 1974 and early 1975 which is likely under the Low Option probably would, of itself, adversely affect the prospects of obtaining outside assistance for FY 1976.

f. The South Vietnamese police and rank-and-file military men, who will be called upon to control demonstrations, strikes, and rioting, are some of the people who have been hit hardest by economic problems. The situation would become critical for the GVN if elements of the police and army were to participate in demonstrations and strikes or to engage in their own organized protest measures. Incidents of police and military involvement in civil disorder occurred in the mid-1960s in South Vietnam, most notably in MR I in 1966. There would be little the Thieu government could do to lessen the economic plight of these groups.

g. Any real domestic challenge to Thieu's position would probably come from his major political base -- the military. While there are no signs of unrest in the military at this time, the political developments outlined above could during FY 1975 create dissension within the officer corps. Middle grade officers, caught between the

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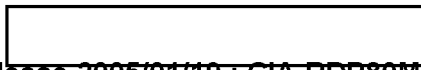
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declining morale and discipline of their men and the unabated corruption and ineffective performance of senior ARVN officers and politicians, could pose a serious threat to the present government. A "Colonels' coup," designed to establish an austere, disciplined, nationalistic South Vietnam prepared to continue the struggle against the Communists, seems unlikely now, but after a period of worsening economic dislocation it could become a serious possibility.

h. The Medium and High Assistance Options: Under the High Aid Option, it is unlikely that there would be any major political consequences. There might be a period of months before the impact of the high level would be felt. During this initial period there could be minor political problems, but the GVN would certainly be able to cope with these before they became serious.

i. Under the Medium Aid Option, the consequences would be more difficult to assess. There would be continued economic stagnation at this level which would be a major problem for GVN policy makers. While there would probably be political reaction, the Thieu government would probably be able to keep the lid on the situation during FY 1975.



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ANNEX

The following assumptions underlie all of the economic projections which are made in this memorandum.

- The security situation will remain the same (no marked improvement over conditions prevailing since the cease-fire agreement in January 1973).
- Military assistance levels to South Vietnam will not change in ways that will affect the availability of foreign economic resources.
- No demobilization of the GVN armed forces will occur.
- The 1974-1975 harvest will be at least as good as 1973-1974, and therefore PL-480 requirements will not increase significantly in real terms.
- There will be no change in the distribution of population (no significant outflow from urban to rural areas).
- Inflows from third-country aid will not exceed an annual rate of \$100 million in CY 1974 and \$200 million in CY 1975, slightly less than half of which will be available for general imports -- i.e., not earmarked for specific projects.
- The private sector will, except under the High Option, actually use all the available aid, i.e., South Vietnamese businessmen will overcome their own uncertainties and will use available capital. Otherwise the economic situation under any of the postulated scenarios would be bleaker than described herein.
- The aid pipeline (the unutilized portion of past funding) will not change significantly during the period.
- The timing of aid for import financing will coincide directly with the period for which the aid is authorized.

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